Charter Schools INSIDER™

Finding Facility Financing

by Joe Keeney

The adage that it is easy to get a loan when you don't need one, but hard to get one when you do, is apt in the charter school sector. Successful charter schools typically have several years of operating experience, established boards, strong enrollment demand and waiting lists, balance-sheet equity (accumulated surpluses) and a proven, reliable history of receiving government funding. These are all excellent credit characteristics that can support long-term, low interest-rate municipal bond financing.

In contrast, *start-up* charter schools typically have none of these characteristics. The challenge facing start-ups is often compounded by

a one-grade-per-year enrollment plan, in which its space needs to grow each year for several years.

Yet hundreds of new charter schools figure out a way to overcome this challenge every year. How do they do it?

Some get lucky. They may be located in a district like New York City that provides space to charters within existing traditional public schools. Or they may find an existing Catholic school that has closed in a diocese that is charter friendly and willing to lease the property at a reasonable cost. Others may operate in a market where there are support organizations that "incubate" start-up charters schools.

Others get creative. There are numerous instances of creative and adaptive re-use of what were nonschool facilities, including redeveloped former retail stores, office buildings, car dealerships, hospitals, factories and churches. Some charter schools add to this creativity by convincing landlords, donors or lenders to support them.

Still others compromise. Some charter schools lease modular classrooms, split across two locations, or start smaller than they would like because of facility constraints. Almost every charter school has to make facility compromises in its early years, but the ones that deliver on their charter promises usually emerge well positioned to take advantage of financing that is readily available to proven operators.

Facility financing can come in variety of forms:

Landlords

Landlord-financed tenant improvements (TI) are probably the most common form of financing received by start-up charter schools. For example, a landlord may be sitting on a building that needs only \$30-\$75 per square foot of improvements. For a 200-student start-up charter school at 100 square feet per student, that would be a requirement between \$600,000 and \$1.5 million. A landlord may be able to self-finance that kind of improvement or obtain a traditional bank loan secured by the building or other assets. (As public school districts slowly start to release their stranglehold on blighted vacant public school buildings, the demand for leasehold improvement funds to bring these buildings back to life is also growing.)

For leases with no "equity" provided by the school, you should be prepared to pay rent equal to 8 percent to 11 percent of the value of the building and improvements. That could translate to rent of $12-$20 per square foot. If your rental payments are below 10 percent of your annual operating budget, that's good. Typical rent payments for charter schools are as high as 10 percent to 15 percent of their operating budgets. Rent above that 15 percent threshold probably will put too much stress on your operating budget.

Bank loans

In some markets, local banks may be prepared to support a charter school with a traditional commercial loan. However, these tend to be low-dollar amounts (often less than $1 million), and unless there is substantial collateral, the "strings" that are attached to these loans can be onerous.

Nevertheless you should reach out to the community development financial institutions (CDFIs) that serve your market. CDFIs are standalone nonprofit lenders that allow their commercial bank sponsors to obtain Community Reinvestment Act credits. CDFIs that are well versed in charter school finance include the Low Income Investment Fund (LIIF) which has lent more than $250 million to charter schools, as well as the Raza Development Fund in Arizona, Self-Help in North Carolina, and the Illinois Facility Fund. Others can be found at www.cdfi.org.

CDFIs are sometimes able to make direct loans from their balance sheets to charter schools (usually up to around $3 million) and co-lend with each other. They also may have New Markets Tax Credits allocations.

New Markets Tax Credits

The NMTC program is administered by the U.S. Department of the Treasury and provides tax credits for investment in low-income communities. To see if your location qualifies, please go to www.policymap.com. One-off NMTC transaction structures are complicated but can offer schools low, effective interest rates and the potential for 100 percent loan-to-value financing (i.e., no equity required by the school).

One of the best new programs in the market is the new $325 million JP Morgan Chase NMTC Fund. This program is "pre-packaged" so deal costs are low and no one has to find the investors. The only catch is that today it is limited to charter schools that have a three-year track record of success and want to expand or replicate. The fund is administered through four partners with many years of charter school lending experience: LIIF, NCB Capital Impact, The Reinvestment Fund (TRF), and Local Initiatives Support Corp. (LISC).

Tax-exempt Bonds

Tax-exempt bonds are the next-best thing to NMTC. They also typically cover 100 percent of project costs and have low total interest costs. Tax-exempt bonds (also called municipal bonds or "munis") typically require a public conduit issuer like a redevelopment authority. Before the mortgage crisis, this form of financing was available to charter schools with a wide range of deal sizes and credit quality; then the market died.

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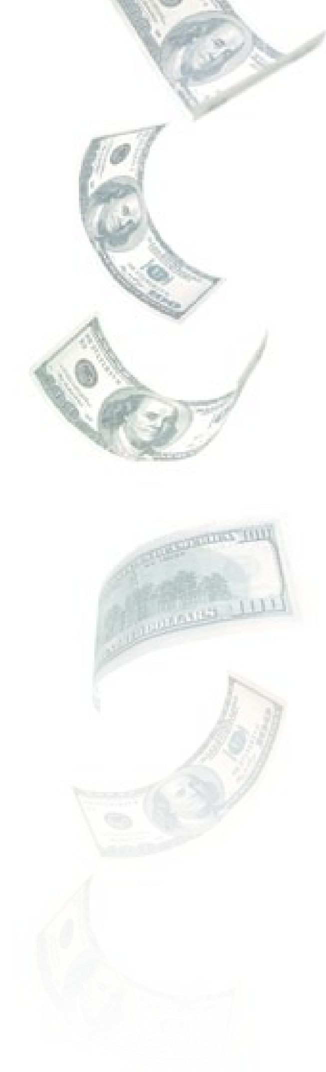
Favorable conditions recently started coming back, however, and a multi-campus charter organization with a BBB-credit rating in Washington, D.C. just closed a $27 million transaction with interest rates in the range of 7 percent to 8 percent. These transactions require substantial documentation, and a banker must market and sell the bonds as an underwriter or placement agent.

Two of the more experienced bankers in this sector are PNC and RBC Capital. Sometimes charter schools also hire financial advisers to assist them through the process. Both the placement agents and financial advisers are paid from the funding proceeds. While most bond issues depend on the credit of the charter school, *Businessweek* recently reported Texas may join Colorado in providing bond guarantees to charter schools.

Nonprofit Charter School Developers

In addition, there are several organizations that explicitly serve the charter school market as nonprofit developers, and some of them provide facility financing and credit enhancement. The most experienced organizations include Civic Builders in New York, Building Hope in Washington, D.C., and Pacific Charter School Development in Los Angeles. These organizations each have unique programs.

For example, Charter School Development Corp. is working on a $100 million charter school program in conjunction with Entertainment Properties



Trust, a real estate investment trust (REIT). Sale and leaseback transactions with REITs or private developers are typically more expensive than tax-exempt bond offerings or NMTC transactions, but in a market with favorable charter school legislation this structure can be utilized by charter schools that may not have a long track record.

For all of these financing strategies, the availability of financing is not dependent only on your school's enrollment demand, real estate collateral or financial projections. Where you are located also matters a great deal. For example, how strong is your charter school legislation (check out www.edreform.org), how has your authorizer behaved when it comes to closing or restructuring schools, how much funding do you receive, and is there an additional facilities funding stream?

As recently as 2004, during a presentation at the National Charter Schools Conference, I likened the radical underfunding of charter school real estate to filling a 10,000-gallon pool cup by cup. I said then that "good neighbors are extending their hoses, and someone, someday will get into the pool-filling business."

The good news is the pool is getting fuller — maybe halfway now. LISC's excellent and thorough report on the *2010 Charter School Facility Finance Landscape* lists a multitude of finance providers and notes that $2.4 billion of tax-exempt bond financing has been deployed by charter schools between 1999 and 2009.

The harsh reality is there is more demand than supply for charter school facility financing, especially for start-ups. But there are thousands of charter schools that have managed to open, expand and succeed through luck, creativity, compromise and the support of many financial providers that truly want to help. You can too!

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